IAG delivers sound result for 1H16 and strengthens risk profile through new reinsurance arrangement

IAG has reported a 1H16 insurance profit of $610 million (1H15:$693 million) and an insurance margin of 14.9% (1H15:13.4%), representing a sound result despite challenging conditions in its core Australian and New Zealand commercial markets.

The Group has also announced a reinsurance package which mitigates exposure to its earthquake and asbestos related liabilities, and the payment of a fully franked special dividend of 10 cents per share (cps) in recognition of its strong capital position.

Key financial indicators are:

- Insurance profit $610 million (1H15:$693 million)
- Reported insurance margin 14.9% (1H15:13.4%)
- Underlying insurance margin¹ 14.2% (1H15:13.3%) including a Berkshire Hathaway quota share positive effect of approximately 250 basis points (bps)
- Gross written premium (GWP) $5.5 billion (1H15:$5.6 billion)
- Net profit after tax $466 million (1H15:$579 million)
- Cash return on equity (ROE) 14.7% slightly below IAG’s 15% through-the-cycle target
- Interim fully franked dividend 13 cps (1H15:13 cps) or 62.7% of cash earnings
- Full year dividend policy range raised to 60-80% and a special dividend of 10 cps reflecting strong capital position

IAG’s consumer businesses in Australia and New Zealand, representing more than 60% of the Group’s GWP, are performing well. This is reflected in strong profitability and modest GWP growth in a low claims inflation environment.

This contribution to GWP growth by the consumer businesses was offset by continued challenging market conditions for IAG’s commercial businesses, with lower GWP reflecting lower average rates and some loss of volume as IAG maintained its strict underwriting disciplines.

The 1H16 reporting period is the first to include the earnings impact of the 20% quota share arrangement with Berkshire Hathaway. The arrangement has met IAG’s expectations, lowering earnings volatility and reducing regulatory capital requirements.

¹ IAG defines its underlying insurance margin as the reported insurance margin adjusted for:
- Net natural peril claim costs less related allowance for the period;
- Reserve releases in excess of 1% of NEP; and
- Credit spread movements.
IAG Managing Director and Chief Executive Officer Peter Harmer said IAG had delivered a sound operating performance in an increasingly complex and dynamic environment.

“We are pleased with the performance of our consumer businesses where we have been able to broadly maintain market share with limited movement on price – demonstrating the strength and resilience of our franchises. In our commercial businesses we are prudently maintaining our underwriting discipline in the most competitive conditions in almost four decades.

“We have initiated a series of changes in the past 12 months, to improve our organisational agility and develop a sharper customer focus, that have helped create a solid platform from which we can look with increased confidence at our future for the benefit of our shareholders, people and customers,” Mr Harmer said.

The slight 1.1% reduction in GWP reflects growth in short tail personal lines and sound growth in Asia, offset by the difficult commercial market conditions and lower compulsory third party (CTP) volumes.

IAG’s profitability was strong with an underlying margin of 14.2% (1H15:13.3%). This is the Group’s preferred measure of business performance.

The Berkshire Hathaway quota share arrangement had a broadly neutral effect on IAG’s reported insurance profit of $610 million (1H15:$693 million) and a favourable effect of around 250 bps on the company’s underlying margin.

The reported 1H16 insurance margin of 14.9% also includes:

- Net natural peril claim costs of $278 million, which were $22 million lower than the related allowance. This net amount includes the benefit of approximately $130 million of recoveries under the Group’s catastrophe aggregate reinsurance cover
- An adverse credit spread impact of $15 million, compared to a favourable effect of $40 million in 1H15
- Prior period reserve releases of $60 million, equivalent to 1.5% of net earned premium (NEP), down from $92 million (1.8% of NEP) in 1H15. This comprised higher than expected CTP releases and a NZ$150 million increase to the risk margin relating to the February 2011 Canterbury earthquake

Net profit after tax of $466 million was 19.5% lower than 1H15 (1H15: $579 million). This includes a significantly lower contribution from investment income on shareholders’ funds, which reflected weaker equity markets in the period.

**Innovative reinsurance arrangements to address earthquake and asbestos liabilities**

IAG has also announced an innovative reinsurance transaction with Berkshire Hathaway that mitigates the Group’s exposure to the Canterbury earthquakes and asbestos related liabilities.

Having exceeded its pre-existing NZ$4 billion reinsurance limit for the February 2011 Canterbury earthquake, IAG has reduced future uncertainty by entering an adverse development cover (ADC) which provides NZ$600 million of protection in excess of NZ$4.4 billion. This provides effective cover of up to NZ$5 billion on the February event after inclusion of IAG’s related risk margin.

The ADC is part of a package of reinsurance which also provides reinsurance protection relating to legacy liability and workers’ compensation policies with exposure to asbestos risk, the majority of the exposure arising from business written by CGU in the 1970s and 80s.
This cover does not affect the management of these portfolios, with IAG continuing to assess, manage and pay claims.

The combined effect of these transactions reduces future uncertainty in relation to these exposures, strengthening the Group’s overall risk profile.

The net impact of the premium paid and the reserves released from the asbestos portfolio is a small net loss, which will be recognised in IAG’s 2H16 results and disclosed in the Group’s net corporate expense line.

Capital management

The Board has determined to pay an interim fully franked dividend of 13 cents per ordinary share (1H15:13 cps) on 30 March 2016, representing a cash payout ratio of 62.7%.

IAG remains strongly capitalised with a Prescribed Capital Amount (PCA) multiple of 1.8 times as at 31 December 2015, which is above the Group’s targeted range of 1.4-1.6. The Common Equity Tier 1 (CET1) ratio was 1.23 times, compared to a targeted range of 0.9-1.1. The Berkshire Hathaway quota share arrangement had a favourable effect on IAG’s regulatory capital position in 1H16 of approximately 10 bps with further benefit expected over the next three years.

In recognition of its strong capital position, IAG will pay a special fully franked dividend of 10 cents per ordinary share, also payable 30 March 2016, and has increased its dividend payout policy to 60-80% of cash earnings on a full year basis, up from 50-70%, with effect from FY16.

At 31 December 2015, after allowing for the interim and special dividend payments, IAG’s PCA multiple is slightly above its benchmark range while its CET1 ratio will be above the mid-point of its targeted range.

DIVISIONAL RESULTS

The Australian Consumer Division which represented 51% of Group GWP, performed well with an underlying margin of 15.5% (1H15:14.0%). The division’s reported margin of 24.6% (1H15:16.0%), included reserve releases significantly above long term expectations, at 8.3% of NEP. The division also enjoyed a favourable natural perils outcome compared to allowance. GWP growth of 1.6% reflected advances in short tail home and motor lines, partially offset by lower CTP volumes.

The Australian Business Division saw a 6.3% contraction in GWP, with a continuation of tough commercial market conditions pushing average rates lower, and strict adherence to underwriting disciplines contributing to lower volumes. The business maintained a double digit underlying margin of 10.7% (1H15:10.7%), assisted by the quota share effect, with synergies from the Wesfarmers integration partially offsetting pressures from the market environment. The reported margin of 8.4% (1H15:6.6%) was lower than the underlying margin following an adverse perils experience versus allowance.

New Zealand continues to perform well, registering a strong underlying margin of 18.4% (1H15:15.9%). The lower reported margin of 1.4% (1H15:19.2%) reflects the increased risk margin for the February 2011 earthquake event, partially offset by a relatively benign natural perils experience. The business has maintained its market-leading position, with modest premium growth in direct personal lines more than offset by the tougher market conditions in the commercial segment, combining to produce a 4.1% decline in GWP.
Asia saw GWP growth of more than 20%, with sound growth in Thailand amplified by a favourable foreign exchange effect. This half also saw the first full six months’ contribution from the small business acquired in Indonesia. Asia’s overall earnings contribution was $10 million (1H15: $17 million), pushed lower by adverse mark-to-market movements on investments.

OUTLOOK

For FY16, IAG continues to expect GWP growth will be relatively flat following the modest contraction in 1H16. The Group’s reported margin guidance remains at 14-16% for FY16 and is now expected to be at the lower end of this range for the full year. Underlying assumptions behind the reported margin guidance are unchanged and include:

- Net losses from natural perils in line with allowance of $600 million
- Prior period reserve releases of at least 1% of NEP
- No material movement in foreign exchange rates or investment markets

Mr Harmer, who announced a new organisation structure in December last year, said the Group was focused on driving future growth and profitability by sharpening its focus on customers’ needs.

“Our goal is to create a company that is customer-led and data-driven, simpler and more scalable, agile and quick to respond to the changes we are seeing in the community and in business – and with the changes we have made I am confident we are well on track to achieving this goal,” he said.
## IAG FINANCIAL PERFORMANCE

<table>
<thead>
<tr>
<th>GROUP RESULTS</th>
<th>1H15</th>
<th>2H15</th>
<th>1H16</th>
<th>1H16 vs 1H15</th>
<th>Mvt</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross written premium</td>
<td>5,603</td>
<td>5,837</td>
<td>5,543</td>
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<tr>
<td>Gross earned premium</td>
<td>5,805</td>
<td>5,720</td>
<td>5,734</td>
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<tr>
<td>Reinsurance expense</td>
<td>(651)</td>
<td>(545)</td>
<td>(1,632)</td>
<td>-30%</td>
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<td>Net earned premium</td>
<td>5,154</td>
<td>5,175</td>
<td>4,102</td>
<td>-20.4%</td>
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<tr>
<td>Net claims expense</td>
<td>(3,481)</td>
<td>(3,460)</td>
<td>(2,589)</td>
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<tr>
<td>Commission expense</td>
<td>(518)</td>
<td>(516)</td>
<td>(423)</td>
<td>-20%</td>
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<tr>
<td>Underwriting expense</td>
<td>(889)</td>
<td>(924)</td>
<td>(654)</td>
<td>-22%</td>
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<tr>
<td>Underwriting profit</td>
<td>266</td>
<td>275</td>
<td>436</td>
<td>+63.9%</td>
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<tr>
<td>Investment income on technical reserves</td>
<td>427</td>
<td>135</td>
<td>174</td>
<td>-61%</td>
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<tr>
<td>Insurance profit</td>
<td>693</td>
<td>410</td>
<td>610</td>
<td>-20.2%</td>
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<tr>
<td>Net corporate expense</td>
<td>(44)</td>
<td>(111)</td>
<td>(14)</td>
<td>-84%</td>
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<tr>
<td>Interest</td>
<td>(52)</td>
<td>(55)</td>
<td>(51)</td>
<td>-10%</td>
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<tr>
<td>Profit from fee based business</td>
<td>10</td>
<td>9</td>
<td>10</td>
<td>10%</td>
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<tr>
<td>Share of profit/(loss) from associates</td>
<td>9</td>
<td>7</td>
<td>8</td>
<td>-22%</td>
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<td>Investment income on shareholders’ funds</td>
<td>137</td>
<td>86</td>
<td>38</td>
<td>-40%</td>
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<tr>
<td>Profit before income tax and amortisation</td>
<td>753</td>
<td>346</td>
<td>601</td>
<td>-20.2%</td>
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<tr>
<td>Income tax expense</td>
<td>(68)</td>
<td>(51)</td>
<td>(67)</td>
<td>-20%</td>
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<tr>
<td>Profit after income tax (before amortisation)</td>
<td>685</td>
<td>295</td>
<td>534</td>
<td>-20.2%</td>
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<tr>
<td>Non-controlling interests</td>
<td>(63)</td>
<td>(39)</td>
<td>(40)</td>
<td>-20%</td>
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<tr>
<td>Profit after income tax and non-controlling interests (before amortisation)</td>
<td>622</td>
<td>256</td>
<td>494</td>
<td>-20.6%</td>
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<tr>
<td>Amortisation and impairment</td>
<td>(43)</td>
<td>(107)</td>
<td>(28)</td>
<td>-56%</td>
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<tr>
<td>Profit attributable to IAG shareholders</td>
<td>579</td>
<td>149</td>
<td>466</td>
<td>-19.5%</td>
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</tbody>
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### INSURANCE MARGIN

<table>
<thead>
<tr>
<th></th>
<th>1H15</th>
<th>1H16</th>
</tr>
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<tbody>
<tr>
<td>Reported insurance margin</td>
<td>693</td>
<td>610</td>
</tr>
<tr>
<td>Net natural peril claim costs less allowance</td>
<td>71</td>
<td>22</td>
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<tr>
<td>Reserve releases in excess of 1% of NEP</td>
<td>(40)</td>
<td>(19)</td>
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<tr>
<td>Credit spread movements</td>
<td>(40)</td>
<td>(15)</td>
</tr>
<tr>
<td>Underlying insurance margin</td>
<td>684</td>
<td>584</td>
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</tbody>
</table>

### About IAG

IAG is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand, Vietnam and Indonesia, employing more than 15,000 people. Its businesses underwrite over $11.4 billion of premium per annum, selling insurance under many leading brands, including: NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and WFI (Australia); NZI, State, AMI and Lumley Insurance (New Zealand); Safety and NZI (Thailand); AAA Assurance (Vietnam); and Asuransi Parolamas (Indonesia). IAG also has interests in general insurance joint ventures in Malaysia and India.

For further information please visit www.iag.com.au.

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